Ketua Pengarah Hasil Dalam Negeri v Firgos (M) Sdn Bhd

HIGH COURT (KUALA LUMPUR) — CIVIL APPEAL NO R2-14–9–09 OF 2012
ZALEHA YUSOF JC
30 JANUARY 2013

Revenue Law — Income tax — Reinvestment allowance — Claim for reinvestment allowance — Claim dismissed by Special Commissioners of Income Tax — Whether items claimed qualified for reinvestment allowance under Income Tax Act 1967 — Whether Special Commissioners of Income Tax exercised discretion properly and lawfully in imposing penalty under s 113(2) of the Act — Income Tax Act 1967 s 113(2)

In the present appeal, the appellant appealed by way of a case stated pursuant to para 34 Schedule 5 of the Income Tax Act 1967 ('Act') against the deciding order of the Special Commissioners of Income Tax ('SCIT'). The respondent was in the business of manufacturing papers, cards and boards which included sheeting, processing and trading papers, cards and boards. The respondent had claimed for reinvestment allowance in the years of assessment 2005 and 2007 amounting to RM3,193,853 and RM205,964, respectively. After conducting a field audit at the respondent's premise, the appellant disallowed the reinvestment allowance claims made by the respondent. However, the SCIT allowed the respondent's appeal. Hence, the present appeal. The issue that arose for determination was whether any or all of the items claimed by the respondent in the years of assessment 2005 and 2007 qualified for reinvestment allowance under the Act; and whether the appellant exercised its discretion properly and lawfully in imposing penalty under s 113(2) of the Act in the year of assessment 2007.

Held, dismissing the appeal:

(1) Reinvestment allowance would be available where a taxpayer had incurred capital expenditure on a factory, plant or machinery for the purposes of a qualifying project. The functionally of the disputed items in the overall context of the respondent's manufacturing activity ought to be taken as a valid factor in considering the respondent's reinvestment allowance claim (see paras 8 & 10).

(2) The warehouse areas were essential and inherent in the nature of the respondent's business. The respondent's raw materials occupied a large amount of space. Without the raw materials, there would be no production. Since the respondent's raw materials were highly flammable, surely it was also good practice standard to have large spaces (see para 11).

(3) Site preparation for plant installation was also vital and formed integral and incidental part of the respondent's manufacturing activity, without which its activity would not be able to function adequately. The installation of the fire-fighting equipments was a requirement by the Fire Department to ensure the safety of the factory and staff, without which the respondent would not have obtained the Certificate of Fitness to occupy the factory. If the respondent's raw materials were to catch fire and there was no fire-fighting equipment installed in the factory, the respondent's business operations would be disrupted and the respondent would also suffer losses. Hence, the installation of fire-fighting equipment was necessary for the construction of the factory as the respondent's raw materials were highly inflammable (see para 12).

(4) All the capital expenditures claimed for reinvestment allowance purposes were actually incurred by the respondent. The respondent had made full disclosure in the Form that were submitted in the years of assessment 2005–2007 and the audit team did not discover anything contrary to the information disclosed in the Form. The respondent had acted in good faith and made full disclosure (see para 16).

[Bahasa Malaysia summary

Dalam rayuan ini, perayu merayu melalui kes dinyatakan berikutan perenggan 34 Jadual 5 Akta Cukai Pendapatan 1967 ('Akta') terhadap perintah keputusan Pesuruhjaya Khas Cukai Pendapatan ('PKCP'). Responden adalah dalam perniagaan membuat kertas, kad-kad dan papan kertas yang termasuk 'sheeting', memproses dan berniaga kertas, kad-kad dan papan kertas. Responden menuntut untuk elaun pelaburan semula bagi tahun taksiran 2005 dan 2007 masing-masing berjumlah kepada RM3,193,853 dan RM205,964. Selepas menjalankan audit di premis responden, perayu tidak membenarkan tuntutan elaun pelaburan semula yang dibuat oleh responden. Walau bagaimanapun, PKCP membenarkan rayuan responden. Maka rayuan ini. Isu yang berbangkit untuk penentuan adalah sama ada apa-apa atau kesemua item yang dituntut oleh responden bagi tahun taksiran 2005 dan 2007 layak untuk elaun pelaburan semula di bawah Akta; dan sama ada perayu menjalankan budi bicaranya secara betul dan sah dalam mengenakan penalti di bawah s 113(2) Akta bagi tahun taksiran 2007.

Diputuskan, menolak rayuan:

(1) Elaun pelaburan semula wujud di mana pembayar cukai telah menanggung perbelanjaan modal atas kilang, loji atau mesin bagi tujuan projek kelayakan. Fungsi item yang dipertikaikan di dalam konteks sepenuhnya aktiviti pembuatan responden patut diambil kira sebagai faktor sah dalam mempertimbangkan tuntutan elaun pelaburan semula responden (lihat perenggan 8 & 10).

(2) Kawasan gudang adalah penting dan semulajadi dalam sifat perniagaan responden. Bahan mentah responden mengambil ruang yang banyak. Tanpa bahan mentah, tidak akan terdapat pengeluaran. Memandangkan bahan mentah responden adalah mudah terbakar, semestinya adalah standard amalan yang baik untuk mempunyai ruang yang luas (lihat perenggan 11).

(3) Penyediaan tapak untuk pemasangan loji juga penting dan membentuk bahagian penting dan sampingan aktiviti pengilangan responden, tanpanya aktiviti responden tidak akan berfungsi dengan memuaskan. Pemasangan pelengkapan kebakaran adalah kehendak Jabatan Bomba untuk memastikan keselamatan kilang dan pekerja, tanpanya responden tidak akan memperolehi Sijil Kelayakan untuk menduduki kilang tersebut. Jika bahan mentah responden terbakar dan tidak terdapat kelengkapan kebakaran dipasang di kilang, operasi perniagaan responden akan tergendala dan responden juga akan mengalami kerugian. Maka, pemasangan kelengkapan kebakaran adalah perlu untuk pembinaan kilang memandangkan bahan mentah responden adalah mudah terbakar (lihat perenggan 12).

(4) Kesemua pembayaran modal yang dituntut untuk tujuan elaun pelaburan semula sebenarnya ditanggung oleh responden. Responden telah membuat pendedahan penuh di dalam Borang yang telah diserahkan bagi tahun taksiran 2005–2007 dan kumpulan audit tidak menjumpai apa-apa yang bertentangan dengan maklumat yang didedahkan di dalam Borang. Responden bertindak dengan suci hati dan membuat pendedahan penuh (lihat perenggan 16).]

Cases referred to

Ketua Pengarah Hasil Dalam Negeri v Kim Thye & Co [1992] 2 MLJ 708, SC (folld)

Ketua Pengarah Hasil Dalam Negeri v Success Electronics and Transformer Manufacturer Sdn Bhd (Rayuan Sivil No R1–14–14 of 2009), HC (folld)

Metacorp Development v Ketua Pengarah Hasil Dalam Negeri [2011] 5 MLJ 447, HC (refd)

Legislation referred to

Income Tax Act 1967 s 113(2), Schedule 5 para 34, Schedule 7A paras 1, 8(a)

Neng Juliana bt Ismail (Wan Hamdenie bt Wan Mohamed with him) (Inland Revenue Board) for the appellant.

Palpanaban Devarajoo (Saravana Kumar Segaran and Donovan Lee Shyun Hun with him) (Lee Hishammudin Allen & Gledhill) for the respondent.

Zaleha Yusof JC:

[1] The appellant is appealing by way of a case stated dated 4 September

2012 pursuant to para 34 of Schedule 5 of the Income Tax Act 1967 ('ITA') against the deciding order of the Special Commissioners of Income Tax ('SCIT') dated 4 May 2012.

[2] By that deciding order, the SCIT, unanimously allowed the appeal by way of Form Q filed by the respondent against the following assessment raised by the appellant ('the assessment'):

Date of Form Q	*Year & Type of assessment*	*Date Of Notice*	*Tax assessed (RM)*
27 August 2009	2005 (Additional)	29 July 2009	19,305.20
27 August 2009	2006 (Additional)	29 July 2009	294,233.72
27 August 2009	2007 (Additional)	29 July 2009	427,689.09

The material part of the deciding order, which can be seen at pp 51–52 of the case stated dated 24 December 2010, read as follows:

> ADALAH DIPUTUSKAN bahawa semua perkara yang Perayu menuntut dalam tahun-tahun taksiran 2005 dan 2007 layak untuk dibenarkan tuntutan Elaun Pelaburan Semula di bawah Akta Cukai Pendapatan 1967 seperti berikut:
>
> (a) Loji dan jentera
>
> Tahun Taksiran 2005
>
> (i) fire-fighting equipment; dan
>
> (ii) electrical fittings
>
> (b) Kilang
>
> Tahun Taksiran 2005
>
> i) warehouse spaces
>
> Tahun Taksiran 2007
>
> ii) site preparation for the installation of the plant
>
> ADALAH DIPUTUSKAN JUGA bahawa Responden tidak wajar mengenakan penalty di bawah Seksyen 113(2) Akta Cukai Pendapatan 1967 dalam Tahun Taksiran 2007.

[3] The respondent is in the business of manufacturing papers, cards and boards which includes sheeting, processing and trading papers, cards and boards. The respondent had claimed for reinvestment allowance in the years of assessment 2005 and 2007 amounting to RM3,193,853 and RM205,964 respectively. The appellant, after conducting a field audit at the respondent's premise vide its letter dated 18 July 2009, disallowed the reinvestment allowance claims made by the respondent on the following items:

Year of assessment 2005

Plant and machinery

(i) Fire-fighting equipment (the appellant disallowed the whole capital expenditure incurred amounting to RM290,000); and

(ii) Electrical fittings (the appellant disallowed 8/11 of the capital expenditure incurred amounting RM245,000).

Factory —

8/11 or 72.7% of the factory which is the warehouse spaces.

Consequently, the appellant disallowed 8/11 of the capital expenditure incurred on the factory which amounts to RM1,811.378).

Year of assessment 2007

Factory

Site preparation for the installation of plant (the appellant disallowed the whole capital expenditure incurred amounting to RM22,9000).

The appellant informed the respondent that the reinvestment allowance claims for the Disputed Items were disallowed due to the following basis-

i) The production area which qualified for reinvestment allowance was 3/11th or 27.3% of the total floor area;

ii) Only 27.3% of the total expenditure of electrical installation is allowed;

iii) The appellant had disregarded the respondent's claim for reinvestment allowance for fire-fighting equipment;

iv) Capital expenditure for the preparation of site for the installation of plant and machinery is not eligible for reinvestment allowance under sch 7A of the Income Tax Act 1967;

v) The reinvestment allowance disallowed by the appellant in respect of the Disputed Items in the relevant years of assessment are as follows:

Year of Assessment	*Reinvestment allowance disallowed*
2005	RM1,367,695
2007	RM13,740

vi) On 29.7.2009, the appellant raised notices of additional assessment ('Form JA') including penalties amounting respectively RM 19,305.20 and RM427,689.09 for the years of assessment 2005 and 2007.

vii) On 27.8.2009, the respondent filed a notice of appeal ('Form Q') dated 27.8.2009 against the appellant's decision in disallowing the reinvestment allowance claimed on the Disputed Items.

[4] The SCIT had, as mentioned earlier, allowed the respondent's appeal. Hence, the appellant now appeals before this court. **A**

THE ISSUES

Reinvestment allowance **B**

[5] Whether any or all of the following items claimed by the respondent in the years of assessment 2005 and 2007 qualify for reinvestment allowance under the Income Tax Act 1967: **C**

(a) Plant and machinery:

Year of assessment 2005:

(i) fire-fighting equipment; and

(ii) electronic fittings **D**

(b) Factory

Year of assessment 2005:

(i) warehouse spaces.

Year of assessment 2007: **E**

(i) site preparation for the installation of plant.

Penalty **F**

[6] Notwithstanding the above, whether the appellant exercised its discretion properly and lawfully in imposing penalty under s 113(2) of the Income Tax Act 1967 in the year of assessment 2007? **G**

THE DECISION

[7] It is appellant's contention that the respondent was only entitled to reinvestment allowance on the capital expenditure incurred for the production area only. The appellant also contends that the SCIT had erred when they relied on the decision of the High Court in *Ketua Pengarah Dalam Negeri v Success Electronics and Transformer Manufacturer Sdn Bhd* (Rayuan Sivil No R1–14–14 of 2009); and when they held that the words 'existing business' must be read together as a whole. **H** **I**

[8] Reinvestment allowance is available where a taxpayer has incurred capital expenditure on a factory, plant or machinery for the purposes of a qualifying project. Paragraph 1 of Schedule 7A of the ITA reads:

A Subject to this Schedule, where a company which is resident in Malaysia

(a) has been in operation for not less than twelve months; and

(b) has incurred in the basis period for a year of assessment capital expenditure on a factory, plant or machinery used in Malaysia for the purposes of a qualifying project referred to under subparagraph 8(a) or (b),

B there shall be given to the company for that year of assessment a reinvestment allowance of an amount equal to sixty percent of that expenditure.

C **[9]** In *Success Electronics* case, the High Court had affirmed the SCIT's decision that reinvestment allowance cannot be restricted to 'production area' alone. In that case, the High Court held that meeting room, office spaces, toilets, staircases, void areas, lift lobby, surau, warehouse, lightning adjustment and installations of air-conditioning, electrical fitting and partition walls were part of the factory. The High Court had affirmed the SCIT's decision and D approved the following principles:

(a) The word 'factory' was not defined for the purpose of this reinvestment allowance… in the absence of such express definition to the word 'factory', the word should then be given its ordinary meaning.

E (b) A factory is a building that is used to manufacture goods which may contain areas for production and non-production.

(c) The imposition of the condition 'production area' based on internal ruling or guidelines of the respondent are without any legal authority and F therefore had no force of law.

(d) The respondent is not entitled to reduce or to disallow the reinvestment allowance claimed under Schedule 7A of the Act based on its own internal ruling or guidelines.

G (e) The functionally of the claimed items in the overall context of the manufacturing process ought to be taken as a valid factor to be considered in giving the appropriate meaning to the word 'factory'.

(f) If the Parliament had intended for the word 'factory' to be narrowly interpreted to mean as was submitted by the Respondent, then an express definition, different from the one provided for the term factory in Schedule H 2, ought to have been so provided in Schedule 7A.

[10] I agree with the respondent that the principle enunciated in *Success Electronics* case shall be applicable here. As submitted by the respondent, the I functionally of the disputed items in the overall context of the respondent's manufacturing activity ought to be taken as a valid factor in considering the respondent's reinvestment allowance claim.

[11] I also agree with the respondent that the warehouse areas are essential

and inherent in the nature of the respondent's business. Even the appellant's witness agreed that the respondent's raw materials occupy a large amount of space. Without the raw materials, there would be no production. Since the respondent's raw materials are highly flammable, surely it is also good practice standard to have large spaces.

[12] To me, site preparation for plant installation was also vital and formed integral and incidental part of the respondent's manufacturing activity, without which its activity would not be able to function adequately. The appellant's witness admitted in evidence that the installation of the fire-fighting equipments was a requirement by the Fire Department to ensure the safety of the factory and staff, without which the respondent would not have obtained the Certificate of Fitness to occupy the factory. If the respondent's raw materials were to catch fire and there was no fire-fighting equipment installed in the factory, the respondent's business operations would be disrupted and the respondent would also suffer losses. Hence, I agree with the respondent that the installation of fire-fighting equipment was necessary for the construction of the factory as the respondent's raw materials are highly inflammable.

[13] The appellant submits that the words '… in respect of manufacturing or processing of a product …' in para 8(a) of Schedule 7A is a phrase that needs to come into heavy consideration in determining the respondent's eligibility to reinvestment allowance. They further submits that manufacturing process/activity is a process of production of articles for use from raw or prepared materials by giving such materials new forms, qualities, properties or combinations, whether by hand labour or machine. The appellant then submits that the eligibility of capital expenditure for reinvestment allowance shall be subject to whether that part of building or whether the plant or machinery is involved in the manufacturing process/activity, or transforming raw materials into an end product.

[14] With due respect, I cannot agree with this line of submission. The words *'existing business' found before the words 'in respect of manufacturing or processing of a product' must be read together as a whole, so that the expression 'existing business in respect of manufacturing or processing of a product' is the more probable expression which is consistent with the intention of the Legislature in enacting para. 8(a) of Schedule 7A.* Refer to *Metacorp Development v Ketua Pengarah Hasil Dalam Negeri* (Judicial Review Application No R2–25–389–2009). If Parliament had intended reinvestment allowance to be restricted only to 'production area', then Parliament would have surely specified this clearly in Schedule 7A. I agree with the respondent that by imposing the condition of 'production area' to the meaning of 'manufacturing', the appellant had clearly acted ultra vires, illegally and without jurisdiction as such was never the

intention of Parliament. The appellant cannot be allowed to usurp the role of Parliament by coining its own definition of 'manufacturing' and drafting its own law.

[15] The SCIT had analysed para 8(a) of Schedule 7A and there is nothing in the appellant's submission to suggest that the SCIT had erred in their decision. The SCIT's reasoning as contained in paras 10.13-10.16 of encl 1 is self explanatory.

[16] On the second issue, even the appellant's witness agreed that all the capital expenditures claimed for reinvestment allowance purposes were actually incurred by the respondent. During the cross-examination, he agreed that the respondent had made full disclosure in the *Borang* that were submitted in the Years of Assessment 2005–2007 and agreed that the audit team did not discover anything contrary to the information disclosed in the *Borang*. I therefore agree with the SCIT that the respondent had acted in good faith and made full disclosure. In *Ketua Pengarah Hasil Dalam Negeri v Kim Thye & Co* [1992] 2 MLJ 708 it was highlighted that s 113(2) of the ITA is not a mandatory provision. This section clearly confers discretion on the appellant as to whether penalty should be imposed or not. What more the matter in dispute arose as a result of technical adjustment ie due to a differing interpretation of the tax legislation by the respondent. Therefore, the decision of the SCIT in the second issue to my mind is also correct.

THE CONCLUSIONS

[17] The SCIT was right when they relied on *Success Electronics* case as the case binds them. The appellant should have also take the same step because unless and until the Court of Appeal sets aside the decision in *Success Electronics*, the decision is a binding authority. Refer to *Metacorp Development*'s case

[18] Under the circumstances, I affirm the deciding order of the SCIT dated 4 May 2012 and the appeal is therefore dismissed with costs.

Appeal dismissed.

Reported by Afiq Mohamad Noor